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No. 162

In the Supreme Court of the United States

OCTOBER TERM, 1960

SANTA MONICA BANK, AND SOUTHWEST BANK OF INGLEWOOD, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals is not yet reported (App. A-1 to A-9).[1] The opinion of the district court is reported at 178 F. Supp. 418 (R. 2a-12a).

JURISDICTION

The judgment of the court of appeals was entered on May 19, 1960. The petition for a writ of certiorari

[1] References to the appendix to the petition will be cited as "App." References to the appendix to petitioners' brief in the court below will be cited as "R."

was filed on June 21, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether unregistered securities received by the petitioners in connection with loans could be sold to the public without registration pursuant to the Securities Act of 1933 on the ground that the petitioners were not "underwriters."

STATUTE INVOLVED

Sections 4(1), 5, and 2(11) of the Securities Act of 1933, 15 U.S.C. 77e, 77d(1) and 77b(11), are set forth below in the Appendix (*infra*, pp. 9-11).

STATEMENT

The court of appeals affirmed an order granting a preliminary injunction restraining the petitioners, and also Guild Films Company, Inc. ("Guild Films") and Hal Roach, Jr., from selling certain shares of Guild Films stock unless a registration statement is filed under the Securities Act of 1933.

In September 1958, Mr. Roach obtained a short term loan from the petitioners of $120,000, depositing, as collateral, stock of F. L. Jacobs Co. Inc. ("Jacobs"), of which company Mr. Roach was a controlling stockholder, and other stock which was subsequently replaced by more Jacobs stock (R. 3a-4a).

The Jacobs stock having dropped in value as a result of having been suspended from trading on the New York Stock Exchange, the petitioners in December 1958 demanded payment of the loan (R. 4a, 49a). Mr. Roach was in financial difficulties (R. 10a) and had

numerous conversations with the petitioners which resulted only in unfulfilled promises. He neither made payment nor deposited additional collateral, which the petitioners insisted upon as a condition to renewal of the loan (R. 58a). Finally, on January 28, 1959, the banks again demanded payment, this time by February 3.

Meanwhile, on January 23, 1959, a deal was being arranged by Mr. Roach whereby Guild Films was to issue stock and notes to a Roach company, W-R Corp., in exchange for certain film rights (R. 7a). Guild Films agreed to use its best efforts to register these shares under the Act, but, as an interim measure to prevent distribution before registration was effected, Guild Films insisted upon the following condition in the agreement:

> "*Stock Taken for Investment:* W-R warrants, represents and agrees that all of the said 400,000 shares of Guild's common stock being contemporaneously issued hereunder, whether registered in the name of W-R or in accordance with the instructions of W-R, are being acquired for investment only and not for the purpose or with the intention of distributing or reselling the same to others. Guild is relying on said warranty and representation in the issuance of said stock." [R. 7a.]

---

[1] Section 4(1) of the Securities Act exempts from the registration requirements "transactions by an issuer not involving any public offering", the so-called "private offering" exemption relied upon to exempt "private placements." *See Securities and Exchange Commission* v. *Ralston Purina Co.*, 346 U. S. 119

On February 3, 1959, the date by which the petitioners had demanded payment, Mr. Roach wired them that he would furnish them 50,000 shares of Guild Films stock. Two days later he persuaded Guild Films to issue a certificate for 50,000 shares. On the instructions of Guild Films, the transfer agent placed the following restrictive legend on the face of the certificate:

> "The shares represented by this certificate have not been registered under the Securities Act of 1933. The shares have been acquired for investment and may not be sold, transferred, pledged or hypothecated in the absence of an effective registration statement for the shares under the Securities Act of 1933 or an opinion of counsel to the company that registration is not required under said Act." [R. 6a.]

The certificate with this legend was delivered to the petitioners, executed in blank on February 12, 1959 (R. 65a). The previous day the Securities and Exchange Commission had suspended all trading in the Jacobs stock so that that stock had no market value. On the day the certificate for the Guild Films stock was received, a Thursday, the petitioners wired Mr. Roach that they were calling the loan and would sell the stock if payment was not received by 8:30 A.M. the following Monday (R. 7a-8a, 66a).

Mr. Roach did not make payment, and the petitioners attempted to sell the stock on the American Stock Exchange, but the transfer agent refused to transfer the

stock because of the restrictive legend. The petitioners, without the knowledge of the Commission, obtained an order in a state court directing a transfer of the stock to them (R. 8a). Thereafter the petitioners commenced a public sale of the Guild Films stock, notwithstanding notice by the staff of the Commission that such sale would be unlawful (R. 12a), whereupon the Commission obtained a preliminary injunction.

ARGUMENT

1. The court below correctly applied the Securities Act in accord with its terms, its purpose, and judicial precedent.

Section 5 of the Act makes it unlawful to sell securities without registration, the means adopted "* * * to protect investors by promoting full disclosure of information * * * necessary to informed investment decisions." *Securities and Exchange Commission* v. *Ralston Purina Co.*, 346 U. S. 119, 124. The statute provides no specific exemption for a sale of collateral by a pledgee. Indeed such an exemption was proposed and rejected.[3] Consequently, the petitioners, as they must, rely upon the exemption from registration in Section 4(1) of the Act for "[t]ransactions by any person other than an issuer, underwriter or dealer".[4] This

[3] H. R. 4314 and S. 875, 73d Cong., 1st Sess. (1933). Section 12 (br. Petitioners' suggestion that the rejection of this exemption was because it was unnecessary and redundant is completely unsupported by anything in the legislative history of the Act.

[4] "[T]he burden was upon the petitioners to establish that they were not underwriters within the meaning of § 4(1)." *Gilligan, Will & Co.* v. *Securities and Exchange Commission*, 267 F. 2d 461, 466 (C. A. 2), certiorari denied, 361 U. S. 896, following the rationale of *Securities and Exchange Commission* v. *Ralston Purina Co.*, 346 U. S. at 126.

exemption, however, is not available to the petitioners because they are participants in a public offering and hence "underwriters" within the broad definition of that term in Section 2(11) of the Act, *infra*, p. 11. As the court below pointed out, reaffirming the view it had expressed earlier in *Securities and Exchange Commission* v. *Chinese Consolidated Benevolent Association*, 120 F. 2d 738, 741, certiorari denied, 314 U. S. 618, and in *Securities and Exchange Commission* v. *Culpepper*, 270 F. 2d 241, 246, Section 4(1) "does not in terms or by fair implication protect those who are engaged in steps necessary to the distribution of a security issue. 'To give § 4(1) the construction urged by the defendant would afford a ready method of thwarting the policy of the law and evading its provisions'" (App. A-8).[5]

It is unquestioned that, in the absence of registration of the stock here involved, neither Guild Films nor Mr. Roach could lawfully have undertaken in February 1959 the distribution which the petitioners commenced. The intervention of the petitioners in the distribution process offers no basis for a different statutory consequence. The petitioners stand in no better position under the statute than either Guild Films or Mr. Roach. The congressional mandate of disclosure to investors is not to be set aside to permit a public distribution of non-registered securities because a creditor desires

[5] The petitioners' attempt to distinguish these cases on the ground that they involved "an original issue of securities" is not consistent with the facts in the cases. In any event, the present case involves an issuance of securities originating with the issuer, which the petitioners sought to distribute to the public.

to collect a loan by selling collateral. There is no warrant for subordinating the public interest to this private interest, whether or not the creditor acted in good faith.[8]

2. Moreover, the facts of this case do not involve a bona fide pledge, where the lender takes securities purely as collateral to secure a promise to pay. Here the loan was in default at the time the stock was delivered and it is certainly consistent with the admitted facts to conclude that the lenders realized at the time they accepted the stock that whatever recovery they were to get would come from its distribution. In fact the district court reached the "ultimate conclusion" that this "was not a pledge transaction at all" (R. 109a) and that when the petitioners received the Guild Films stock from Mr. Roach they were "no longer looking for or hoping for payment from him" (R. 114a). The court below did not disagree, but itself stated that "the banks should have known that immediate sale was almost inevitable if they were to recoup their loans from the security received" (App. A 9). Although we believe, as the court below held, that registration would be required even if this had been an ordinary collateral situation, there can be no doubt that regis-

[8] The petitioners' suggestion that a bank can never dispose of collateral in the event of default because it cannot file a registration statement is without basis. If the borrower is neither the issuing corporation nor a person having any relation to the issuer, no problem of registration is involved. If the borrower is the issuer, a person in control of the issuer, or a person who bought from either of them, the bank must tread carefully when it accepts unregistered stock as collateral. A careful bank could and does protect itself in such a situation by requiring a commitment by the issuer that, upon default, registration under the Act will be effected.

tration is required where the securities to be sold were actually transferred and taken with the specific intention that they be distributed in order to obtain repayment of the loan.

CONCLUSION

The decision below is clearly correct. There is no conflict nor need for further review. The petition for certiorari should be denied.

Respectfully submitted.

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JULY, 1960.

APPENDIX

The Securities Act of 1933, 48 Stat. 74, as amended, provides in pertinent part:

* * * *

SEC. 4 (1), 15 U.S.C. § 77d(1):

Exempted Transactions

SEC. 4. The provisions of section 5 shall not apply to any of the following transactions:

(1) Transactions by any person other than an issuer, underwriter, or dealer; transactions by an issuer not involving any public offering; or transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter and transactions in a security as to which a registration statement has been filed taking place prior to the expiration of forty days after the effective date of such registration statement or prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter after such effective date, whichever is later (excluding in the computation of such forty days any time during which a stop order issued under section 8 is in effect as to the security), and except transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of

such securities by the issuer or by or through an underwriter.

SEC. 5, 15 U.S.C. § 77e:

Prohibitions Relating to Interstate Commerce and the Mails

SEC. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this title, unless such prospectus meets the requirements of section 10; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 10.

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8.

Sec. 2(11), 15 U.S.C. § 77b(1):

Definitions

Sec. 2. When used in this title, unless the context otherwise requires—

* * * * * *

(11) The term "underwriter" means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.